

Globalization: The Big Picture

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The Growth in Global Trade

- In 1985, the value of world exports was less than \$2 trillion.
- Less than 20 years later in 2003, the value of world exports had grown to \$7.3 trillion.

The Benefits of Free Trade

- Increases in Economic Welfare
- Greater Variety in Consumption
- Promotes More Efficient Use of Scarce Resources
- Promotes Innovation and Competition
- Generates Economic Growth
- Disseminates Democratic Values
- Fosters Economic Freedom

Key Points

- We must understand that many of the benefits to free trade to a nation occur in the aggregate.
- Certain groups within a nation may actually experience a loss as a result of free trade.
- While the losses of these groups are smaller than the gains to the overall economy, they should not be completely ignored.

The groups that oppose free trade tend to focus on the distributional effects

- In terms of major economic regions, the industrialized nations dominate world trade.
- Western Europe, North America, and Asia account for well over 80% of world trade.
- Looking at North American exports:
 - ◆ Over 40% stay in North America
 - ◆ Over 37% go to Western Europe and Asia
 - ◆ Only 4% go to Africa, the Middle East, Central and Eastern Europe, the Baltic States, and CIS

Commodity Composition of World Exports

| Products | Share in 1980 | Share in 2002 |
|-----------------|---------------|---------------|
| Agricultural | 14.7% | 9.3% |
| Mining Products | 27.7% | 12.6% |
| Manufactures | 53.9% | 75.1% |

Arguments made by anti- Free Trade groups since NAFTA

- Over 3 million manufacturing jobs have been lost (1 million are due to NAFTA)
- The job export crisis is expanding from manufacturing to high tech and services
- Estimates of future outsourcing are chilling
- Trade deficits have soared
- Real wages of U.S. workers have been flat or declining
- U.S. Income and wage inequality have jumped

Outcomes

- Economic adjustments that are part of the natural churn in an economy are blamed on free trade.
- Hot-button issues such as outsourcing become major political topics.
- The most radical in opposition to free trade try to disrupt the activities of groups that seek to decrease the use of trade barriers (such as GATT or now the WTO)

Outsourcing: How many jobs are involved?

- Good data related to this issue is scarce
- One estimate suggests that roughly half a million jobs have moved offshore in the last three years
- The current estimates are that 3.3 million jobs will be outsourced by 2015

Outsourcing: How many jobs are involved?

- This is a small percentage of the 137 million people employed in the US
- This is less than 2% of the 15 million people that involuntarily lose their job each year

What Does Economic Theory Have to Say?

- Outsourcing is closely related to technological change
- There are overall efficiency gains and cost reductions
- There are also job losses that tend to be concentrated among certain groups of workers and in certain communities

Benefits

- Catherine Mann (One of your speakers tomorrow) of the Institute of International Economics estimates that GDP growth would have been 0.3% lower from 1995 – 2002 without outsourcing
- Outsourcing may also accelerate the formation of innovative new products and services (the jobs of the future)

Top 10 Arguments made by groups that oppose the WTO

- The WTO is fundamentally undemocratic
- The WTO will not make us safer
- The WTO tramples Labor and Human rights
- The WTO would privatize essential services
- The WTO is destroying the environment

Top 10 Arguments made by groups that oppose the WTO

- The WTO is killing people
- The WTO is increasing inequality
- The WTO is increasing hunger
- The WTO hurts poor, small countries in favor of rich, powerful nations
- The WTO undermines local level decision-making and national sovereignty

Those Opposed to Free Trade tend to Advocate the use of Trade Barriers

- There are a number of arguments for Protection.
- Many have received a lot of political attention but may not make economic sense
- Others do have the potential to work under the right circumstances
- We need to examine some of the more popular ones.

Is Protectionism Ever a Good Idea?

- Our trade theories tell us that generally free trade is the best policy
- Why, then, is there so much protectionism?
- What are the arguments for protectionism, and are any of them valid?

Invalid Argument #1 for Protectionism: Patriotism

- “Be American Buy American”: may be a legitimate marketing slogan, but it doesn’t make for good trade policy
- Why do consumers wish to buy imported products, anyway?
- Protectionism takes away choice, and causes higher consumer prices
- Protectionism often lowers national welfare: is this patriotic?

Invalid Argument #2 for Protectionism: National Employment

- Unemployment high? Why not restrict imports? Wouldn’t this put Americans to work?
- No, because:
 - ◆ reduced income of trading partner lowers their demand for our exports
 - ◆ our trading partners will likely retaliate
 - ◆ our protection may trigger a dollar appreciation

National Employment, cont'd

- Protection lowers demand for foreign currency, causing it to become less valuable (the \$/yen rate falls)
- This means our currency strengthens
- This makes our exports less competitive on global markets, and encourages domestic consumers to substitute towards cheaper imports

National Employment, cont'd

- Bottom line: jobs may be saved in the protected industry, but jobs in our export industries will be lost
- In the U.S., export-industry jobs pay better on average than import-competing industries
- Generally, unemployment has risen slightly in response to protectionism
- Why not try fiscal or monetary policy instead?

Invalid Argument #3 for Protectionism: Fallacy of Composition

- Some say protection is OK because what's good for a certain industry must be good for all industries, right?
- This is the “fallacy of composition”
- Consider Bastiat's “Petition of the Candlemakers” (1854) as an example of how odd this argument can be.

Invalid Argument #4 for Protectionism: “Pauper Labor”

- It's not “fair” for our companies to compete with countries with low wages, right?
- Labor's not the only factor of production
- Labor productivity matters, too: maybe our workers get paid more because they are more productive

Valid Argument #1: Government Revenue

- All governments need revenue to operate
- Tariffs, and perhaps quotas, can be used to generate government revenue
- Trade taxes are attractive because:
 - ◆ they are easy to collect
 - ◆ there may not be much income to tax
 - ◆ it may be possible to pass some of the tax burden along to other countries

Valid Argument #1: Government Revenue

- Caveats:
 - ◆ tariffs lead to inefficiency and deadweight loss, as consumers face higher prices and relatively inefficient production is expanded
 - ◆ wouldn't some sort of consumption tax be better?

Valid Argument #2: Income Redistribution

- As we have seen, tariffs redistribute income from the owners of the relatively abundant factor to the owners of the relatively scarce factor
- If this is the goal, fine: it will be costly, however

Valid Argument #2: Income Redistribution

- Also, in general tariffs redistribute income from consumers to producers
- Sometimes governments have tried to use commercial policy to help the poor by
 - ◆ imposing tariffs on “luxury” items: this taxes the rich
 - ◆ imposing export taxes on “necessities”: this keeps goods at home and leads to lower prices

Valid Argument #2: Income Redistribution

- However, eventually this encourages domestic production of luxury items and discourages production of necessities: this might be exactly what the government doesn't want
- It might be better to redistribute income by means of a progressive income tax

Valid Argument #3: Infant Industry Protection

- Basic idea: a country should protect a new industry from foreign competition until it grows up and gets big enough to realize economies of scale; that country may develop a comparative advantage!
- It is plain that domestic consumers will have to pay for this, but they may eventually benefit from having a globally efficient producer

Valid Argument #3: Infant Industry Protection

- Problems:
 - ◆ Are there really economies of scale in the protected industry? If not, then the industry will never pay back what it cost to protect it
 - ◆ Protection may simply lead to inefficiency
 - ◆ There are typically factors at work to preserve the protection forever

Valid Argument #3: Infant Industry Protection

- Example: Harley-Davidson
 - ◆ Until 1981 H-D only produced large motorcycles
 - ◆ Facing increasing import competition, H-D successfully lobbied for infant industry protection of their new smaller motorcycle production
 - ◆ Import share fell from 65% in 1981 to 31% in 1984

Valid Argument #3: Infant Industry Protection

- Example: Harley-Davidson
 - ◆ Domestic production increased, but prices rose by \$400 - \$600 per motorcycle
 - ◆ Each job saved at H-D cost the public \$150,000
 - ◆ But: H-D did increase its share of the domestic market, and asked for the protection to be dropped in 1987, a year ahead of schedule
 - ◆ H-D continues to be profitable

Valid Argument #4: Terms of Trade

- We've seen from offer curves that a country will improve its terms of trade by imposing a tariff or a quota, as long as it isn't "small"
- However, this assumes that the trading partner does not retaliate

Valid Argument #5: Welfare-Enhancing Tariffs

- Tariffs or quotas can improve a country's overall welfare if the country is large enough
- However,
 - ◆ the trading partner may retaliate
 - ◆ income may be redistributed away from consumers

Valid Argument #6: Tariffs to Offset Dumping

- Dumping occurs when:
 - ◆ one country sells its product at a lower cost in the foreign market than in its domestic market, or when
 - ◆ one country sells its product below cost in the foreign market

Valid Argument #6: Tariffs to Offset Dumping

- There are three types of dumping:
- Permanent (or persistent) dumping occurs when a foreign firm continually sells its product for a lower price than domestic firms
 - ◆ Often, this is because the firm faces competition when exporting, but has a monopoly at home
 - ◆ We should be happy about this

Valid Argument #6: Tariffs to Offset Dumping

- Sporadic dumping occurs when the foreign exporter occasionally liquidates a surplus on the domestic market
 - ◆ Since this sort is short-term by definition, tariffs probably do more harm than good here

Valid Argument #6: Tariffs to Offset Dumping

- Predatory dumping: the idea is to sell below cost until rivals fold; then the predator can raise price to monopoly level
- However, domestic firms could then enter the market again
- It isn't clear why a firm would want to do this
- Still, if this behavior occurs it is probably inefficient

Valid Argument #7: Countervailing Duties

- When our trading partners subsidize their industries, we can punish those countries with tariffs designed to “level the playing field”
- Milton Friedman says we should send a thank-you note to taxpayers in the subsidizing country
- Still, subsidies may harm producers

Valid Argument #8: Tariffs to Increase Employment in a Particular Industry

- Even if overall employment isn't increased under protectionism, tariffs can be used to increase employment in a particular industry.
- This will be costly, however. Consumers will be paying for every job created.

Costs of Protectionism

| Industry | Jobs Saved | Consumer Cost per Job Saved | Annual Welfare Cost to U.S. |
|-----------------|------------|-----------------------------|-----------------------------|
| Costume Jewelry | 1,067 | \$96,532 | \$5,000,000 |
| Frozen OJ | 609 | \$461,412 | \$35,000,000 |
| Luggage | 226 | \$933,628 | \$26,000,000 |
| Machine Tools | 1,556 | \$348,329 | \$35,000,000 |

Valid Argument #8: Tariffs to Increase Employment in a Particular Industry

- It would be cheaper to charge consumers a special tax to pay the salaries of these workers!

Other Possibly Valid Arguments

- National Defense
- Environmental Concerns
- The Protection of Cultural or Social Values
- National Pride
- “Strategic” Trade Policies: tariffs on monopoly exporters